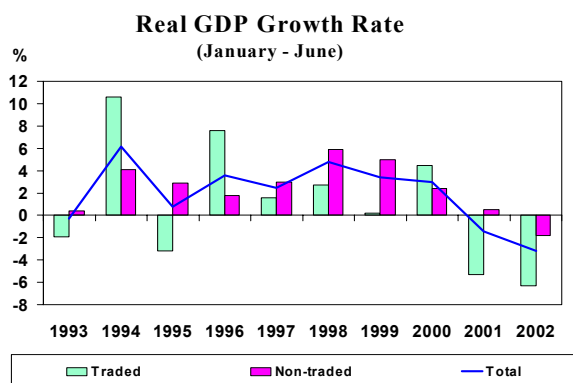


REVIEW OF THE ECONOMY FOR THE FIRST SIX MONTHS OF 2002

Real economic activity in Barbados weakened further during the first half of 2002, with total output estimated to have declined by 3.2%, more than double the rate of contraction of the corresponding period of 2001. However, most of the decline was concentrated in the first quarter, as a better performance in the sugar, manufacturing and construction sectors resulted in a decline of only 0.3% in the second quarter versus 5.8% in the first quarter. The traded sectors bore the brunt of the depressed economic conditions in the first six months of the year,

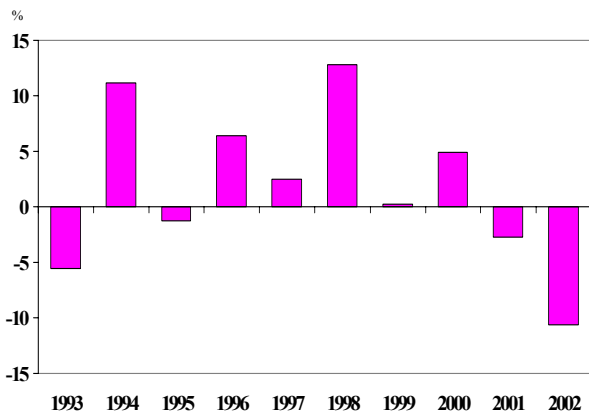
slumping by 6.3%, while output in the non-traded sectors decreased by 1.8%.

The outturn for the traded sector was driven by a slump in the key tourism industry, where real value added contracted by an estimated 9.5% as a result of declines in both long-stay arrivals (10.6%) and cruise passengers (6.3%). Visitors from the United Kingdom plummeted by 15.8% primarily because of the pullout of a number of chartered flights as well as World Cup football in Asia which may have diverted some tourists who would otherwise have visited Barbados. Similarly, Canadian and European arrivals fell by 19.1% and 23.5% respectively, as sharpening regional competition and the increasingly price-sensitive nature of these markets, eroded the demand for Barbados' tourism product. The US market bucked the declining trend of the other extra-regional markets and grew by 4.4% over the six-month period. This expansion was facilitated



by an increase in the marketing efforts of the Barbados Tourism Authority and the arrival of the scheduled carrier U.S. Airways, which opened-up access to non-traditional US gateways. The outcome of the intra-regional tourism market was mixed, with visitors from Trinidad & Tobago rising by 10%, while tourist arrivals from other CARICOM destinations decreased by 9.1%. The reduction in the number of cruise passengers was the result of cruise line companies adjusting ship itineraries to avoid losses brought on by the worldwide economic slowdown.

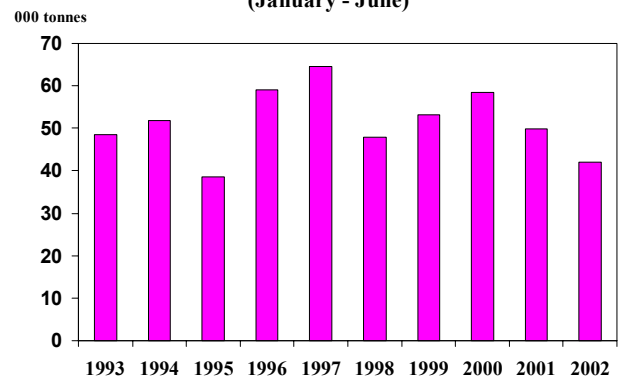
Long Stay Tourist Arrivals
(January - June)



The performance of the agricultural sector during the January to June period was poor. Sugar production fell by 10% due to a contraction in acreage planted and a late start to harvesting. Additionally, non-sugar

agricultural output is estimated to have declined by about 2.6%, as an increase in chicken and food crop output was insufficient to offset decreases in fish catches and milk production.

Sugar Production
(January - June)



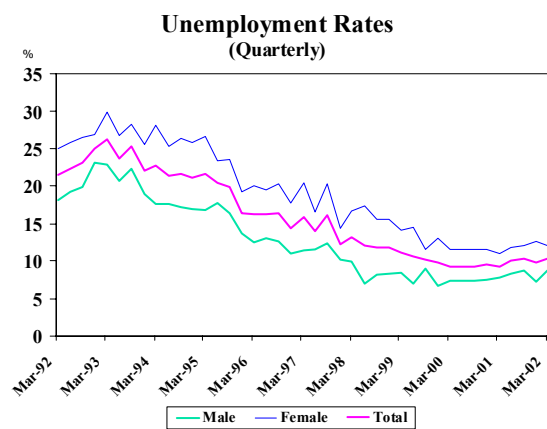
There was a modest recovery in the fortunes of the manufacturing sector in the first six months of the year, with output expanding by an estimated 0.7%, in contrast to a 10.4% fall in the same period of 2001. This represents the first rise in manufacturing output in the January to June period in the past three years. The improvement was driven by an increase in the production of processed foods and “other manufacturing” industries. These sub-sectors appeared to have benefited from the “Buy Local” campaign and the hike in import duties on specific items.

The international business sector grew more slowly in the first half of 2002 than in the comparable period of 2001, due to an uncertain international regulatory environment which weighed heavily on the industry. Consequently, most of the sub-categories registered declines in the number of new licences granted. One hundred and nineteen new licences were issued for international business companies over the review period, six fewer than in the corresponding period of 2001. Eight new licences were distributed to societies with restricted liabilities compared to fifteen in 2001, while one licence was issued for the operation of an offshore bank, a fall-off from the three given in 2001.

Despite the continuation of several public sector capital projects, activity in the construction sector slowed further as several private sector projects wound down or were completed. Consequently, output in the construction sector is projected to have decreased by an estimated 8.3% during the first half of the year, following declines of 1.8%, and 0.4% in the comparable period of 2001 and 2000. The weak performances in tourism and construction activities led to a reduction in output in the related mining and

quarrying, wholesale and retail and business and other services sectors.

The depressed economic conditions resulted in the unemployment rate rising by a full percentage point to 10.3% in the first quarter of 2002, over the corresponding period of 2001. Employment losses in the agriculture, manufacturing, and construction sectors exceeded job growth in Government and the financial and business services, causing a net contraction in employment of 2,200 persons. Both sexes were equally affected by the recession, with the unemployment rates for both males and females rising by about one percentage point, to reach 8.8% and 12.0%, respectively.



The inflation outturn benefited from low international oil prices and by February 2002, the twelve-month average rate of inflation was unchanged at 2.6% over the comparable

period in 2001. Increases in the price of food, alcoholic beverages, housing, transportation and medical and personal care were counterbalanced by declines in fuel and light, and the clothing and household operations indices.

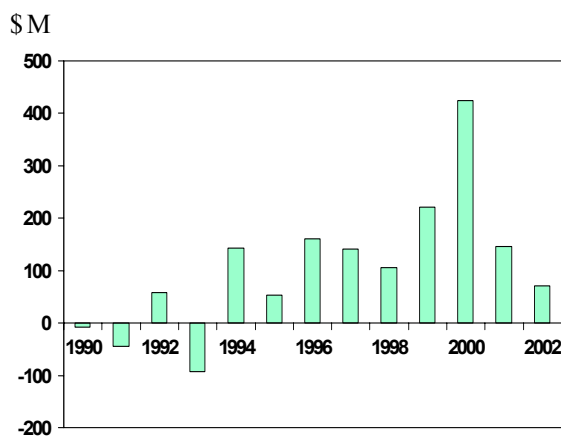
The lowest second quarter expansion in foreign reserves (\$3.3 million) since 1993, constrained the growth in the NIR to \$71.5 million during the six-month period of 2002. However, the most significant causal factor in the overall reserve increase was a 4.5% fall in retained imports, on account of consumer caution and weak domestic economic activity which led to a reduction in the demand for motorcars and imported machinery. The decrease in imports was significant enough to outweigh the broad-based decline in merchandise exports (8.9%) and the 7.8%

contraction in travel credits to produce a small current account surplus. In addition, reserve growth was also contained by a lower capital and financial account surplus which was about \$5.1 million below the \$78 million recorded in 2001.

Government's fiscal position deteriorated sharply over the comparable first half of 2001, with the fiscal deficit growing by \$97 million to reach \$155 million. The deficit's expansion was because of rising capital expenditures and a shrinking economic base, which pushed down tax revenues by 8.1% (\$70.7 million). Direct taxes declined by 13.5% (\$55.5 million) as corporation taxes slumped by 26.4% (\$41.6 million), and personal income taxes grew by less than a percentage point. Indirect taxes contracted by 3.3% (\$15.1 million) on account of reductions in VAT collections and excise taxes of 3.9% (\$10.1 million) and 26.7% (\$9.9 million), respectively. Despite the fall-off in imports, the imposition of a 60% tariff on selected imports resulted in Government receiving an additional 35%(\$20.2 million) in import duties.

Current expenditures declined by 1% (\$8 million) during the half-year, as falling wages and salaries and lower interest payments

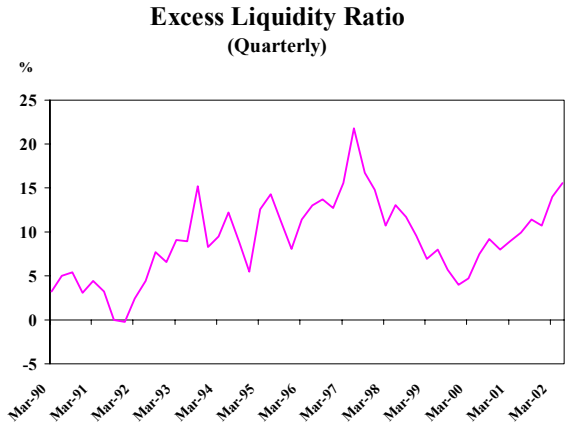
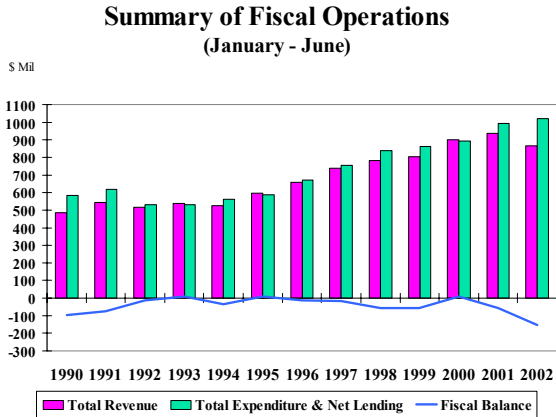
**Change in the Net International Reserves
(January - June)**



offset increases in transfers and subsidies and goods and services. The 5.9% (\$19.4 million) contraction in wages and salaries can be attributed to the absence of repayments of the 8% wage cut which had boosted this category of expenditure in the same period of 2001, while the 10.7% (\$13.7 million) decrease in interest payments was a direct consequence of the prevailing low interest rates on Government securities. However, transfers and subsidies and Government's consumption of goods and services rose by 6.6% and 7.8%, respectively. Capital expenditure grew by 19.7% (\$34.5 million) as a result of ongoing work on several Government projects, including the South Coast Sewerage Project, Edutech, and the airport expansion project.

financed by domestic sources. In particular, the combined effects of a reduction of Government's deposits at the Central Bank and an increase in the Ways and Means account caused Central Bank financing to Government to expand by \$106.4 million above the corresponding period of 2001. Commercial banks and the National Insurance Scheme also raised their financing to Government by \$80.9 million and \$33.6 million, respectively. However, the low interest rates induced the non-financial private sector, trust companies and finance houses, to decrease their holdings of Government securities by \$83.2 million in total. Net foreign financing was up marginally over last year to reach \$17.2 million.

The prevailing level of liquidity in the banking system allowed the bulk of the deficit to be



The increasing level of excess liquidity in the banking system during the review period was reflective of the weakness in the economy.

By the end of June 2002, the excess liquidity ratio was 15.6%, almost a full five percentage points higher than the rate recorded at the end of 2001. Over the identical period domestic deposits rose by 10.1% (\$396.1 million), almost quadrupling the figure for the corresponding period of 2001. This outturn was the result of the depositing of cheques from the sale of the Life of Barbados shares in the banking system, Government's net injection of funds into the economy through the draw-down of its deposits at the Central Bank and the shift of trust companies' investments from Government securities into bank deposits. In light of the sluggish domestic demand, credit to the non-financial private sector was unchanged over the six month period. The stagnation in private sector credit occurred across a broad range of industries including manufacturing, tourism and construction. Despite the prevailing high liquidity levels, the average interest rate on all loans from commercial banks fell by less than half of a percentage point over the review period, to 10.7%. However, the average interest rate on selected loans declined by 0.9 of a percentage point to 8.4%. All banks had virtually met the Central Bank's target rate of 8.5%.

OUTLOOK FOR THE REMAINDER OF 2002

The Barbadian economy is not expected to exhibit signs of recovery before the first quarter of 2003, with current projections suggesting a decrease in real economic activity of about 3% of GDP for 2002. Output is projected to fall across most sectors but the largest declines are forecasted to be in the traded sectors. The international financial turmoil and the weakness in the UK market indicate that the tourism sector will continue to struggle, despite the recent gains made in the United States market. Manufacturing and non-sugar agriculture will have to continue to grapple with a liberalised trading environment although the implementation of the WTO safeguard mechanism may provide some respite for these sectors. The construction industry should receive a boost from Government's accelerated capital works programme, the start of the proposed Needhams Point development, and an expansion in the National Housing Corporation's housing programme. However, caution among consumers and businesses could well counter the increase in public capital expenditure, leading to little or no growth in construction activity in 2002. Wholesale and retail activity is anticipated to contract in light of the weakness in the

tourism and construction sectors. Only electricity, gas and water and the mining industries are currently forecasted to post positive gains in output of above one percentage point. Based on international trends, inflation should remain well within the tolerable range of 2.5% to 3%, but the current economic climate makes it likely that the unemployment situation will deteriorate further.

The NIR is projected to decrease by a small amount by year-end as a consequence of slowing private capital inflows and a sluggish tourism sector. However, the current account should improve, since the prevailing weakness in the economy suggests that the fall-off in retained imports is likely to be greater than the reduction in tourism receipts and domestic exports.

As a result of a projected contraction in tax revenue and rising current and capital outlays, the projected deficit for the calendar year 2002 is likely to be approximately 5.5% of nominal GDP, a figure which is significantly greater than that of the 3.5% deficit of the preceding year. This suggests that Government needs to exercise caution in its spending lest the deficit be further exceeded. Domestic excess liquidity is also

expected to remain high despite increased demand for financing by the Government sector, as individuals and firms remain cautious.

Potential investors should use the opportunity of high levels of excess liquidity in the system to fund new projects through corporate bond issues.

In order to stimulate new business lending, the Board of the Central Bank took a decision at its last meeting to extend the small business guarantee facility to qualifying credit unions. Criteria for eligibility will be worked out in collaboration with our Bank Supervision Department.

While our projections suggest that the second half of the year will show an improved outturn on the first half, the changing structure of the Barbados economy has made it more difficult to predict outcomes with a high degree of certainty.

July 30, 2002